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SENSITIVE
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TAGS: EFIN ECON EAID XM XA XH XB XF FR
SUBJECT: PARIS CLUB - JANUARY 2009 TOUR D'HORIZON AND DISCUSSIONS
ON METHODOLOGICAL ISSUES

¶1. (SBU) Summary: During the January 2009 Paris Club Tour d'Horizon, creditors agreed to consider committing up front to a debt reduction for Seychelles, although they agreed that conditions should be stringent. While Haiti's situation was challenging, the International Monetary Fund (IMF) believed that a review of Haiti's performance on its program under the Poverty Reduction Growth Facility (PRGF) could take place in February, with Completion Point later in 2009. The IMF reported DRC's performance had been encouraging under very challenging circumstances and the Fund was proceeding with plans for a rapid access Exogenous Shock Facility and for a PRGF program around midyear. The DRC has reportedly also made some progress renegotiating the proposed $9 billion Chinese loan package, but details were not available. Guinea had been set to reach Completion Point in early 2009, with negotiations in March, but this had fallen away as a result of December's coup, with no current prospects for getting back on track. The Club also discussed Afghanistan, Argentina, Burundi, Cote d'Ivoire, Ecuador, Grenada, Iraq, Mongolia, Serbia, and Sri Lanka.

¶2. (SBU) Methodological issues discussed included outreach to non-Club creditors, the Club's Annual Report, and "new types of debt buyback offers and repayment profile adjustments to developing countries." The U.S. delegation warned that elements of the proposed buyback options raised significant legal, budgetary and policy issues, and that the issue of comparability of treatment

clauses in voluntary operations needed to be resolved before the Club considers any more such operations.

Afghanistan

¶3. (SBU) The U.S. and others had asked to put Afghanistan on the agenda because of recent developments regarding the country's IMF program. The IMF reported that the situation remained challenging, because of drought, increasing violence, and a weak government. GDP was expected to grow 3.5% in the current fiscal year (ending sometime in March), with inflation above 30%. Revenue collections were weak, in part because of the poor security situation, but also because of undervaluation of fuel imports and poor customs enforcement. Performance on structural benchmarks was also poor. The February PRGF program review had consequently been delayed, but a mission would be leaving for Kabul toward the end of January and a review could take place in April or May if agreement were reached during the mission.

¶4. (SBU) The Bank reported that under IDA 15, Afghanistan is set to receive $650 million during FY09-11, with $230 million in FY09, including $30 million in budget support. There had been progress on triggers, but more effort was needed, including on tracking

poverty-reducing expenditures, mining, civil service reform and pensions. PRSP implementation and macro performance were both weak, although the trigger on debt management had been met, with a contract having been concluded for a debt management system. Debt reporting was on track, and even on a website, while Afghanistan had normalized relations with several creditors and been prudent with new borrowing.

Burundi

¶5. (SBU) Burundi's Completion Point remains on track, with Board decisions planned for late January and negotiations in March. HIPC relief would be worth about $832 million in Net Present Value (NPV) terms, with the Multilateral Debt Relief Initiative (MDRI) adding another $117 million. The ratio of NPV of public debt to exports would fall from 967% at end-2007 to 148% at end-2009. Burundi would no longer be in debt distress, but would remain at high risk,

needing grants and highly-concessional lending as well as a stronger export base.

Cote d'Ivoire

¶6. (SBU) The IMF reported that the Board had discussed the preliminary HIPC document, which found the country eligible for HIPC under the revenue window on the basis of end-2007 data. In response to Executive Directors' comments, the proposed triggers (e.g., public financial management, transparency) might be strengthened but also streamlined. The Board had emphasized the importance of good performance under the EPCA program, if Decision Point were to be brought at the same time as the PRGF program.

¶7. (SBU) The IMF did not yet have end-2008 data on which to judge performance, but it appeared that fiscal performance had been "mixed," with some cuts in spending on the new capital, declining oil and cocoa-related revenues, and issues relating to taxes on staples, meaning that the primary fiscal target may have been missed. A mission was planned for early-February; it would review the EPCA performance through end-2008 and explore the PRGF and 2009 budget. If the mission's assessment were positive, a Board date could come in March, following financing assurances at the March Club meeting.

¶8. (SBU) The Bank representative noted that the Board discussion of the preliminary paper had been a major step, but that significant challenges remained, including clearance of AfDB arrears and reaching agreement on the PRGF program and Completion Point

triggers. Cote d'Ivoire had also recently requested $60 million from IDA's Debt Reduction Facility (DRF) to clear $827 million in commercial debt arrears. The amount requested appeared not to match the need and the Bank was not sure whether the DRF could or should address just arrears, rather than the total commercial debt (estimated at $2.3 billion.

DRC

¶9. (SBU) The IMF reported that DRC had been subjected to major shocks - the international financial crisis, the collapse of metals prices, especially those of copper and cobalt, and the escalating conflict in the eastern part of the country. As a result, revenues were less than expected and security expenditures higher, causing a deterioration in the fiscal position. Inflation had risen, and the GDP growth estimate for 2008 lowered from 10% to 8%. Given these issues, performance under the SMP had been broadly satisfactory, with end-September quantitative targets mostly met and good performance on structural benchmarks.

¶10. (SBU) A December Fund mission had reached preliminary agreement on 2009 policies, which would include zero borrowing from the central bank, a fiscal deficit below 2.6% of GDP, and tight monetary

policy to reduce inflation to 12% by year-end (from 24% at end-2008), all in the context of growth estimated at 4.5% of GDP. Nevertheless, there was severe pressure from the deteriorated terms of trade - gross reserves were down to less than $100 million (one week of imports) and a $600m gap was projected for 2009, leading the Fund to examine a rapid access ESF program for 25% of quota ($200m). While the World Bank and others would also help fill the balance of payments gap, the Fund expected further growth in bilateral arrears.

¶11. (SBU) The IMF also reported good progress on resolving misreporting issues dating from 2005 spending, with an audit to be completed in February to confirm the government's remedial measures. If resolved, the issue would be brought to the Board along with the ESF program, perhaps in late February or early March. A PRGF program would not come before mid-2009, meaning that Completion Point would likely come no earlier than 2010.

¶12. (SBU) The IMF reported the DRC and China had apparently agreed to drop the second infrastructure tranche (of $3 billion), and had initiated discussions on sovereign guarantees and concessionality, but no further details were available. The Letter of Intent for the ESF would commit DRC not to proceed with the loan unless it was compatible with sustainability. The World Bank representative had similar information, adding that Bank President Robert Zoellick had

raised the matter during a visit to China. Construction of Phase I of infrastructure has apparently begun. The Bank was also planning fast-track assistance under emergency procedures, with a late January/early February Board meeting planned for a $100 million program. The Secretariat reported that a PRC firm had taken over a South African company's work on the mining feasibility study, which was due by end-March. The Paris Club chair noted need for early international support for countries like the DRC, where officials' weak technical capacity made them ill-equipped to negotiate contracts with China.

Ecuador

¶13. (SBU) The discussion focused on Ecuador's recent bond default and the November 2008 public debt audit commission's report that purported to justify it. The Secretariat observed that the Ecuadorian authorities had distanced themselves from the report's conclusions on the Club and mentioned the discussions relating to Ecuador's $50 million IDB loan. The World Bank reported some delay in payment, but Ecuador has generally paid on time. The Bank is reviewing disbursements and grants carefully; by June one operation and four trust funds will remain. In a winding down strategy, the Bank approved the last operation in December 2007, but is watching

the macro impact of oil and other factors.

Grenada

¶14. (SBU) Grenada had requested an extension of its treatment to correspond with its Fund program, and at the December meeting the Club agreed to a U.S. suggestion that Grenada be asked to provide an update on comparable treatment before making a decision. Grenada responded to the request, indicating that it was seeking comparable treatment from Taiwan, but that it had not approached Algeria and that it did not wish to request comparable treatment from Kuwait or Trinidad and Tobago, as they were both disbursing new loans - a clear violation of Grenada's obligations to the Club. (Grenada also indicated that Libya had informally agreed to debt forgiveness, but that this had not been formalized; Libya was not billing, however, and Grenada was not paying.) The U.S. argued that this information did not support an extension. The UK asked about implications of not granting an extension. The Secretariat stressed the language in the Agreed Minute which required Grenada to pursue comparability of treatment from its other creditors. IMF said implications were limited and Grenada could manage if the Club denied the extension.

Guinea

¶15. (SBU) In December, the IMF representative had reported that Guinea was on track for Completion Point in early 2009, with negotiations in March. All that had changed as a result of the military coup following the death of President Conte. The new ruling body blocked some mining operations, launched audits of ministries, lowered prices and promoted military personnel, presumably raising the wage bill. The AU and ECOWAS condemned the coup and suspended GOG participation. No data had been provided since the coup. The Fund was unable to engage until members recognized the new regime, so delays on the PRGF and Completion Point were inevitable.

Haiti

¶16. (SBU) The IMF reported that there had been riots over food and fuel prices, forcing the Prime Minister to resign. The four storms that hit Haiti in August and September had imposed losses estimated at 15% of GDP, and the U.S. and Canadian slowdowns were reducing exports and remittance flows. As a result, the current account

deficit was higher than expected, 2.6% of GDP, although inflation had receded from 20% in September to 14% in November. Performance had actually been "broadly satisfactory," although for 2009 there was a pressing need to respond to the humanitarian crisis and to repair infrastructure damaged by the storms. Inflation was expected to be below 10% due to lower global food and fuel prices, but the balance of payments would be worsened by the loss of crops (60% of harvest destroyed) and by the need for higher fuel imports to supply new power plants.

¶17. (SBU) The fourth review of Haiti's program would likely take place during the first half of February, with the fifth review and Completion Point in mid-2009. There would also be a donors' conference towards the end of March 2009. The Bank reported that progress on triggers was satisfactory, and had helped IDA increase interim debt relief.

Iraq

¶18. (SBU) The Secretariat reported that the final tranche of Iraq's treatment took effect on December 17, as agreed, and that the Club would issue a press release. The Fund noted the very successful completion of Iraq's SBA, and reported that a mission in mid-March

would discuss a follow-on program. The Bank indicated that an interim strategy note foresaw assistance of some $500 million, all from IBRD, since there had been current account and fiscal deterioration as a result of the fall in oil prices. Creditors received Iraq's letter apologizing for problems with the first round of payments, which had been due on January 2.

Mongolia

¶19. (SBU) The IMF reported that Mongolia had performed well over the past few years, with growth averaging 9% per annum and per capita income doubling, driven by gold and copper mining. The country had been running significant fiscal surpluses, and its debt had fallen from 51% of GDP at end-2004 to 24% at end-2007. The boom had come to an abrupt end with the price of copper plunging 68% since July. There was pressure on the exchange rate, and a loss of confidence that had led to a bank run. The fiscal situation was worsening, with revenues from minerals having fallen by fully 3% of GDP in 2008, and expected to fall a further 6% of GDP in 2009. The balance

of payments shifted from a surplus of 2.7% of GDP in 2007 to a projected 9% deficit in 2009. The country lost 40% of its reserves to just two and a half months of import cover. A mission was in Ulaanbaatar to discuss a possible SBA in the next three weeks, but

revenue sources were hard to find. The Bank, participating in the Fund mission and reprioritizing its support, believed that an additional $75 million in concessional resources was needed, of which the Bank could provide perhaps $10-15 million. Additional support would be needed from other donors.

Serbia

¶20. (SBU) The Netherlands noted that Serbia's SBA was being discussed at the IMF the following day, and complained that the IMF paper had reported that "negotiations on settling remaining official external arrears are ongoing" and that "restructuring agreements were concluded with Paris and London Club creditors in 2001 and 2004, respectively, and are being implemented." Neither of these statements was true, according to the Netherlands, and the Serbs were acting in bad faith. A tour de table revealed that a number of countries had not yet signed agreements with Serbia, although there were differences as to whether there were serious obstacles. The Secretariat said it would draft a letter to send to the Serbian authorities.

Seychelles

¶21. (SBU) The IMF reported that the country's program was being implemented "with determination," and that all December 2008 quantitative indicators appeared to have been met. The 2009 budget was in line with the program, although structural measures were still being implemented. The slowdown had been worse than expected because of weak tourism, although inflation had increased from a 32% annual rate in October to 60% in November as a result of the depreciation, goods and services tax changes, and increases in managed prices. The first review mission would head to Seychelles in the first half of February, with discussion of the results possibly in late March. The Bank reiterated its draft two-year interim strategy to provide budget support of $9 million in both 2009 and 2010.

¶22. (SBU) The Secretariat argued for stringent conditions, suggesting that the agreement cover three years and that it therefore be conditioned on a follow-up Fund program. The Secretariat argued against upfront reduction, suggesting that the Club choose between reduction towards the end of the agreement or a three-phase agreement with entry into force conditioned in part on the progress made with private creditors. Some creditors, including the U.S. delegation, were concerned about making decisions without adequate data and without a Debt Sustainability Analysis (DSA).

Germany went a step further, arguing that there was no clear need for a reduction, since IMF documents referred in some places to "reduction" and in others to "restructuring." The UK agreed that conditionality would be crucial, but suggested the Seychelles could object to a requirement for a follow-up program because of elections in 2011. After lengthy discussion, including a U.S. request that the IMF prepare several scenarios for the Club to consider, the Club provided four possible schedules to the Fund and requested DSAs for each. These range from a two-year treatment with reduction at the first review and at the end of each year, to a four-year treatment with reduction at the ends of years 2, 3 and 4. Negotiations are scheduled for March.

Sri Lanka

¶23. (SBU) The IMF representative reported little change in Sri Lanka's situation since December's pessimistic briefing, except that reserves had declined by a further $300 million. The Bank indicated that some of its $318 million in planned assistance for FY09 could slip to FY10. The Netherlands raised an arcane issue about the country's DSA - apparently authorities had not consented to publication of the most recent DSA, which had concluded that the country was at "high risk" of debt distress. As a result, the

Fund's website still listed the country at "moderate risk," based on the previous DSA.

Methodological Discussion: Outreach

¶24. (SBU) There was a lengthy discussion of outreach to non-Paris Club creditors following a working paper and letter circulated by the Secretariat. Germany began with a strong view that the Club should carefully examine the claim structure and behavior of creditors before proceeding. The Secretariat replied that it had two aims - improving data flow and increasing the provision of comparable treatment. It particularly asked members for their views on allowing three "category 1" creditors - Brazil, Israel and Korea - to participate fully in tours d'horizon, including methodology discussions.

¶25. (SBU) Most creditors agreed that the Club should remain flexible, considering steps and invitations on a case-by-case basis. All creditors agreed that asking creditors to share data was a good first step, but the U.S. - supported by Belgium and Germany - successfully argued that it was premature to invite full participation in tours (in particular, the methodology discussions), and that the Club should first examine Brazil, Israel and Korea's

responses on data sharing and their record on providing comparable treatment.

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Methodological Discussion: New Types of Debt Buyback Offers
and Repayment Profile Adjustments to Developing Countries
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¶26. (SBU) The Secretariat suggested new kinds of treatment that the Club might provide, and changes to Club methodology in estimating market prices used in buybacks. It also suggested the Club consider embedding prepayment options in reschedulings and willingness to help smooth payments for countries managing their debts. The embedding option was not well received, with many creditors arguing that it would add another level of complexity to negotiations; the idea was shelved. There was more openness to the payment-smoothing proposal, although creditors generally stated that they needed more time to consider the idea. The U.S. raised significant concerns about both embedding and smoothing, noting that they raised significant legal, budgetary and policy issues. The U.S. also called for resolution of comparability of treatment clauses in voluntary buybacks and prepayments before any future buyback operation.

PEKALA